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DEPT PASS TO USTR CLILIENFELD/AADLER/CHINCKLEY
DEPT PASS TO TREASURY FOR OFFICE OF SOUTH ASIA MNUGENT
TREASURY PASS TO FRB SAN FRANCISCO/TERESA CURRAN
USDA PASS FAS/OCRA/RADLER/BEAN/CARVER/RIKER
EEB/CIP DAS GROSS, FSAEED, MSELINGER

E.O. 12958: N/A
TAGS: ECON EAGR EAIR ECPS EFIN EINV EMIN ENRG EPET ETRD
BEXP, KIPR, KWMN, IN

SUBJECT: NEW DELHI WEEKLY ECON OFFICE HIGHLIGHTS FOR THE WEEK OF
FEBRUARY 9 TO FEBRUARY 13, 2009

¶1. (U) Below is a compilation of economic highlights from Embassy New Delhi for the week of February 9-13, 2009, including the following:

-- India Modifies FDI Procedures
-- Inflation Continues to Fall
-- December Industrial Output Falls
-- Interim Railway Budget Announced
-- FII Holdings Fall to Five Year Low
-- J&K Chief Minister Invites India Inc to Kashmir
-- GOI Waives Duty on Newsprint Paper
-- Leading Retailer in Trouble
-- Retailers Back out of Leases
-- U.S. Retailers Try to Divest IT Assets Without Causing Local Job Losses
-- McDonald's Plans Expansion in India in 2009
-- Bharti Foundation Recognized for CSR Activities

India Modifies FDI Procedures

¶2. (U) In a bid to address the present economic slowdown in India, the Cabinet Committee on Economic Affairs (CCEA) on February 11 liberalized guidelines used to determine the amount of foreign direct investment (FDI) in sectors that are subject to FDI caps. The move is geared towards facilitating greater foreign capital inflows into the country. The new guidelines outline procedures for the calculation of foreign investments in Indian companies and the transfer of ownership or control of Indian companies in sectors that currently have foreign direct investment (FDI) caps. Under the new guidelines, downstream investments by an Indian company that has foreign investment but is owned and controlled by Indians will not be considered FDI.

¶3. (U) Currently, Press Note 9 (1999) governs foreign direct investments enabling foreign-owned Indian holding companies to make downstream investments under the automatic route. In recent years, the government has counted existing FDI in the Indian partner of a joint venture with a foreign company - called indirect investment - towards the FDI cap in the joint venture. In response to industry and investor comments, the CCEA press release

(http://pib.nic.in/release.asp?relid=47408) clarified the norms for calculation of foreign investment.

¶4. (U) A real-life example of how the new rules could potentially operate is illustrated by the case of the Indian telecom company Vodafone Essar (VE). The overall cap for foreign investment in the telecom sector remains 74 percent. However, the UK parent company (Vodafone) will be able to raise more FDI since, in addition to its 42 percent direct holding in VE, it has an additional 10 percent indirect foreign holding in VE - via money invested through other companies that are "controlled and managed" by Indians. Previously, Vodafone would be deemed to hold a combined 52 percent stake in VE. Under the new policy, Vodafone's 10 percent indirect holding, invested through Indian-controlled companies - is not deemed FDI, effectively meaning that Vodafone owns 42 percent of VE for purposes of the FDI cap and now has an additional 10% of equity that it could invest in VE without breaching the FDI cap.

Inflation Continues to Fall

¶5. (U) Year-on-year inflation for the week ending January 31 fell to 4.39%, down from the prior week's reading of 5.07%. This brings wholesale price inflation to its lowest level since January 2008. Much of the decline was attributed to the government's reduction in controlled energy prices, which was implemented on January 28. Energy and mining prices actually experienced contractions, while food article inflation remained stubbornly in the double-digit range at 11.5%. The overall continued decline in inflation has fuelled expectations that the central bank, the RBI, will institute further policy rate reductions. The last interest rate reductions were on January 2.

December Industrial Output Falls

¶6. (U) According to the latest official estimates, industrial production in India fell 2 percent in December 2008 - the largest recorded year-on-year decline in any month in 15 years. The drop was attributed to a 2.5% reduction in manufacturing sector growth. The remaining 20 percent of the India's Index of Industrial Production (IIP) is comprised of mining and electricity. Both of the latter components showed declining, but still positive, growth. Despite the contraction in industrial output, many economists do not see this as a threat to the Central Statistical Organization's (CSO) advance forecast of 7.1 percent GDP growth for the current Indian fiscal year (FY) 2008-09, which ends March 31. The official estimates project manufacturing growth at 4.1 percent for the whole fiscal year.

¶7. (SBU) Analysts view the drop in the production of consumer durables as industry caution over perceived falling consumer confidence in making big-ticket purchases. However, Prime Minister's Economic Advisory Council (EAC) member Saumitra Chaudhari has dismissed the 12.8 percent fall in consumer goods output as an anomaly, stating that the IIP will show a recovery in the final quarter of the current fiscal year (January-March 2009). (Comment: Several Embassy contacts question the accuracy - although not the trend direction - of the IIP since its base year is 1993-94 and the basket of goods and reporting firms has not been updated since then. End comment.) Industry, meanwhile, is expecting a revival in demand in the second half of 2009. General Motors India president and managing director Karl Slym has told the media that some positive results of the fiscal packages are expected in three months when the consumer actually increases spending. Similarly, consumer durable firms reported a significant upswing in consumer durable sales, such as televisions and refrigerators, in January.

Interim Railway Budget Announced

¶8. (SBU) Railway Minister Lalu Prasad Yadav presented the (interim) railway budget for FY 2009-10 on February 13, including a number of populist measures aimed at upcoming national elections. Lalu has served as Railways Minister since 2004, proudly avoiding raising passenger fares yet still generating revenues. Some of the highlights of his interim budget include a marginal reduction in

passenger fares for all classes, a 2-percent cut in air conditioned and mail express trains, introduction of 43 new train services, plans to start high speed bullet trains, laying of new rail lines and more passenger amenities. Lalu said that Indian Railways plan to invest $47 billion (Rs 2300 billion) in the 11th Five Year Plan (2007-12) to increase the transport capacity of the railways and to reduce the unit cost of operations.

FII Holdings Fall to Five Year Low

¶9. (U) Foreign institutional investors (FIIs) in India's stock markets significantly reduced their equity through 2008, in the process lowering the percentage of their holdings to 15.5%, the same level it was in end-2003. In value terms, FII equity is still higher than December 2003, coming in at $94 billion. Meanwhile, domestic institutional investors (DIIs) - mainly mutual funds, insurance companies and banks - have stepped into the breach and raised their holdings of portfolio equity to 8.86%, surpassing retail investors for the first time. The rise of DIIs is a sign of a deepening financial market.

J&K Chief Minister Invites Industry to Kashmir
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¶10. (U) Recently elected Jammu and Kashmir Chief Minister Omar Abdullah addressed members of the Federation of Indian Chambers of Commerce and Industry (FICCI) at its annual general meeting on

February 12. He was part of a "Session with Chief Ministers" that also included re-elected Delhi Chief Minister Sheila Dixit and Madhya Pradesh CM Shivraj Chouhan. The 39-year old Abdullah, a very comfortable public speaker with good English, exhorted the audience to visit Kashmir to discover for themselves the improvement in security and the opportunities for investment. He stressed to the packed and receptive audience that he was not trying to pressure the FICCI members into business commitments. Rather, Abdullah invited the industry chamber members to vacation in his state, at which time they would discover for themselves the investment opportunities that Jammu and Kashmir provided. FICCI General Secretary Amit Mitra committed at the panel session to holding a FICCI retreat in Kashmir.

¶11. (U) Abdullah also noted that major cell phone service provider Airtel had invested in the state, as well as conglomerate Essar. Airtel senior executive Rajan Bharti Mittal shared the dais and stated that Airtel has been in the state since 2004 and has always got "tremendous support" from the government. Chief Minister Abdullah said his business development goals for the state were improving infrastructure, especially connectivity, and tax incentives. He pointed out that a new international air route had recently opened between Srinagar, Kashmir and Dubai, which he hoped would increase foreign tourism. Finally, to make the Line of Control into a "Line of Commerce," Abdullah identified the need to establish communication and financial links across the Line of Control between India and Pakistan. Otherwise, he asserted, trade was limited to barter trade, since potential business partners cannot place orders or confirm payment.

GOI Waives Duty on Newsprint Paper

¶12. (U) On February 11, the GOI announced a reduction in the duty on newsprint (uncoated paper) and lightweight coated paper used for newspaper and magazine publishing, respectively. Previously, the duty rates were three and five percent on these two items. Since newsprint is fully exempted from excise duty, it will also be exempt from countervailing and special additional duties. Newspaper and magazine publishers had pressed for the measure due to increased international prices and declining ad revenues.

Leading Retailer in Trouble

¶13. (U) Subhiksha Trading Services, one of the country's largest grocery chains, has closed 1,600 stores and laid- off most of its workers, according to media. Through the end of 2008, the chain was opening stores at a rate of 50 per month with the expectation that

expansion would be funded by an international investor. When the economic crisis struck in September, press reports, the investor walked away from the deal and credit to finance store openings was no longer available. As a result, the chain was not able to pay salaries, rents or suppliers. The company is now looking to restructure its $153 million debt with the government and 13 lenders. Unable to pay employees and security guards, reportedly over 600 of the chain's stores have been looted.

Retailers Back out of Leases

¶14. (U) Local media reports that many retailers are currently moving out of spaces they had leased due to their inability to pay high rental rates that were agreed to prior to the economic slowdown. Over the past two years, projections of the Indian retail sector touted its significant growth potential, prompting retail chains to rapidly expand and sign leases wherever they could find space. The anticipated increase in business led to an inflation of rental rates, so drastic that retailers took their landlords to court to dispute sharp rent increases. As the economic slowdown has hit India, retailers have not been able to afford high rental rates and have been forced to reevaluate their business strategies, resulting in the closure of outlets, store size reductions and

postponement of expansion plans. They have also seen local financing options narrow and become more expensive. Retailers have reportedly been reneging on their leases and moving to cheaper spaces in order to cope with the slower economic growth and the lack of available credit. Over the past couple of months, landlords have been filing cases against several of India's larger retail operations, including Pantaloon Retail and Subhiksha, for failure to pay rent. High rental rates and litigation add to the difficulties retailers have faced in expanding and developing their businesses.

U.S. Retailers Try to Divest IT Assets Without
Causing Local Job Losses

¶15. (SBU) Retail giants Walmart and Target are each in negotiations to sell their information technology (IT) offices in Bangalore to information technology majors such as IBM, Infosys, and WIPRO. While the price tags for these operations remains uncertain, a Walmart Global executive told Consulate General Chennai that his company estimates that its Bangalore IT offices provide services worth nearly USD 300 million per year. A Target executive also confirmed to us his company's plans to sell its Bangalore IT shop, emphasizing that Target sees the move as a way to rationalize its cost and personnel structure.

¶16. (SBU) Both companies are keen on ensuring that the sales of their IT arms do not damage their longer-term aims of entering into, and succeeding in, India's retail market. Executives from both companies told us that the companies want to shield themselves from any bad publicity that would result from a divestiture that resulted in job losses (together, Walmart and Target's operations in Bangalore employ around 4000 people). Both companies are therefore making sure that any sale includes provisions that the buyer retain employees currently working in the retailers' Bangalore offices.

McDonald's Plans Expansion in India in 2009

¶17. (U) The fast-food chain plans to open 40 new restaurants in India by the end of this year, according to managing director Amit Jatia. McDonalds serves 180 million Indian customers per year through its 155 locations and expects its customer growth rate to expand at 30-40 percent per year. The company will invest Rs.120 crore (approx $25 million), excluding real estate costs, in its expansion plan this year. "We are also increasing our headcount to 7000 from 5000 at a time when most companies are either cutting costs or reducing employee numbers," said Jatia.

Bharti Foundation Recognized for CSR Activities
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¶18. (U) Bharti Foundation, the philanthropy arm of Bharti Enterprises, received the 2008 Best Practices Award for its Social

and Corporate Governance Responsibility activities. Bharti Enterprises is one of India's leading business groups working in telecommunication, agri-business, insurance, and retail. The prestigious award was founded by the Bombay Stock Exchange Limited, Nasscom Foundation, and Times Foundation to honor organizations for their contributions to society. Bharti Foundation was this year's recipient for introducing the Satya Bharti School program which provides free, quality education to rural underprivileged children, with a focus on the girl child. At present, about 158 Satya Bharti primary schools are operational across the states of Punjab, Haryana, Rajasthan, and Uttar Pradesh with a staff of 600 teachers and a total enrolment of more than 17,000 children. Bharti Foundation plans to set up another 500 primary schools and 50 senior secondary schools to enroll an additional 200,000 children.

¶19. (U) Visit New Delhi's Classified Website:
http://www.state.sgov/p/sa/newdelhi

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